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SUBJECT: QUARTERLY REVIEW OF THE SOUTH AFRICAN ECONOMY WITH KEY ECONOMIC STATISTICS

REF: STATE 08 134905

¶1. (U) Summary: The deterioration in the global economic landscape affected South Africa's third quarter 2008 economic performance. Weaker international demand, falling commodity prices, and the tight domestic economic environment resulted in the lowest quarterly real GDP growth in ten years. Unemployment increased from 23.1 percent in the second quarter to 23.2 percent in the third quarter. The current account deficit increased from 7.3 percent of GDP in the second quarter to 7.9 percent in the third quarter. A combination of direct and other investment inflows financed the current account deficit in the third quarter, while portfolio investment switched to a net outflow. The outflow was prompted by global financial risk and a reduction in commodity prices, which also resulted in a significant depreciation in the rand during September and a subsequent fluctuation around lower levels. Uncertainty and volatility in global financial markets also affected the South African Reserve Bank's reserve accumulation which led to a slight decrease in foreign reserves in the third quarter of 2008. CPIX-inflation peaked at 13.6 percent in August, before decelerating to 12.1 percent in November, while growth in the broadly defined M3 money supply and credit extensions to the private sector also decelerated further in the third quarter. Declining inflation and credit demand together with weakening domestic and international economic conditions allowed the South African Reserve Bank's Monetary Policy Committee (MPC) to reduce interest rates by 50 basis points in December. End Summary.

The sources for the following tables are from the South African Reserve Bank (SARB), Statistics SA, and the Customs Department of the South African Revenue Service. Some figures from previous months may have changed as the result of statistical revisions.

¶I. MONTHLY FIGURES

¶2. EXCHANGE RATES
Rand/US Dollar Exchange Rate (monthly average):

2007	2008		
Sep 7.13	Jan 6.99	May 7.62	Sep 8.05
Oct 6.77	Feb 7.64	Jun 7.92	Oct 9.67
Nov 6.70	Mar 7.98	Jul 7.64	Nov 10.12
Dec 6.83	Apr 7.79	Aug 7.66	Dec 9.94

Trade-Weighted Rand (monthly average; 2000 = 100):

2007	2008		
Sep 75.82	Jan 74.68	May 66.29	Sep 66.11
Oct 78.65	Feb 67.98	Jun 63.85	Oct 57.32
Nov 77.92	Mar 63.13	Jul 65.69	Nov 56.61

Dec 77.03	Apr 64.31	Aug 67.66	Dec 56.73

Comment: The rand depreciated by 31.5 percent against the dollar and 25.2 percent against the trade-weighted average exchange rate of the rand in 2008. The sharp decline in the exchange rate was caused by global financial turmoil, with investors rechanneling funds to familiar, mature markets, as well as by the drop in international commodity prices, which constitute a large percentage of South Africa's exports. The significant appreciation of the US dollar resulted from increased investment in US assets by risk-averse investors. The movement in the rand was not unique as most commodity-producing, emerging-market countries with large current-account deficits experienced significant declines in their currencies. End Comment.

¶3. INFLATION (year-on-year, not seasonally adjusted)
Q3. INFLATION (year-on-year, not seasonally adjusted)

	2008 Jul	Aug	Sep	Oct	Nov
CPI	13.4	13.7	13.1	12.1	11.8
CPIX	13.0	13.6	13.0	12.4	12.1
PPI	18.9	19.1	16.0	14.5	12.6

Comment: Almost all inflation-targeting countries, including South Africa, continue to experience inflation rates in excess of their inflation targets. South Africa's inflation was primarily driven by the rising prices of energy and food. CPIX-inflation (CPI minus mortgage interest) peaked at 13.6 percent in August, more than double the upper limit of the inflation target range of 3 to 6 percent, before decelerating to 12.1 percent in November. Producer price inflation was 19.1 percent in August, the highest rate in 22 years, before decelerating to 12.6 percent in November. The Monetary Policy Committee's (MPC's) most recent central inflation

forecast projects that inflation will continue its downward trajectory and return to within the target range in the third quarter of 2009. Inflation is expected to average 6.2 percent and 5.6 percent in 2009 and 2010, respectively. Monthly inflation is expected to drop by as mush as 3 percent in early 2009, when StatsSA implements a new inflation basket that gives less importance to food and fuel costs. The MPC highlighted the exchange rate as the most significant upside risk to the inflation outlook. End Comment.

¶4. MONEY AGGREGATES (percentage change over 12 months)

	2008 Jul	Aug	Sep	Oct	Nov
M1	7.64	2.40	4.57	4.67	2.61
M2	13.86	9.45	10.17	11.61	11.76
M3	18.10	15.42	15.23	15.59	16.26

Comment: After a two-year period of high growth in the broadly defined money supply (M3), some moderation set in towards the end of 2007 and became more pronounced in 2008. The deceleration in M3 growth reflected tighter credit conditions, diminishing wealth effects as asset prices receded, and slower underlying growth in income and expenditure. End Comment.

¶5. DOMESTIC CREDIT EXTENSION TO THE PRIVATE SECTOR (percentage change over 12 months)

2008 Jul	Aug	Sep	Oct	Nov
19.43	18.52	16.28	16.36	15.30

Comment: Growth in private sector credit extension continued to moderate amid tougher economic conditions and tighter credit conditions. The progressive tightening in the monetary policy stance, which began in the middle of 2006, has slowly but surely reduced credit demand by households and corporate sectors. Furthermore, consumers' purchasing power was eroded by inflation, household balance sheets were undermined by stagnant house prices and volatile financial markets, and lending standards were raised by the National Credit Act (NCA). Economists believe this downward trend in credit extension will continue in 2009. In a typical credit cycle, credit growth starts rising only 12 to 18 months after the first cut in interest rates. Consequently, the December

interest rate cut is not expected to bolster credit growth until the first half of 2010. However, some economists expect that the 2010 World Cup may cause a "feel good" reaction that would accelerate the expected consumer response to lower interest rates. End Comment.

¶6. KEY INTEREST RATES (at end of month)

2007	Aug	Sep	Oct	Nov	Dec
SARB Repo Rate	12.00	12.00	12.00	12.00	11.50
Prime Overdraft Rate	15.50	15.50	15.50	15.50	15.00

Comment: The South African Reserve Bank's Monetary Policy Committee (MPC) reduced the key policy interest rate, the repo rate, by 50 basis points to 11.5 percent in December, ending a period of unchanged monetary policy during its August and October meetings. The rate cut was made possible by declining domestic inflation and weakening domestic and international demand. Most analysts believe there will be further interest rate cuts in 2009. End Comment.

¶7. MERCHANDISE TRADE ACCOUNT (R millions)

2008	EXPORTS	IMPORTS	TRADE BALANCE
Jan	39,356.8	49,573.2	-10,216.4
Feb	46,946.3	52,766.1	-5,819.8
QFeb	46,946.3	52,766.1	-5,819.8
Mar	51,150.9	56,181.0	-5,030.1
Apr	56,174.3	66,169.0	-9,994.7
May	56,240.5	57,900.0	-1,659.5
Jun	60,159.9	60,343.8	-183.9
Jul	61,268.2	75,599.6	-14,331.4
Aug	60,390.9	65,514.4	-5,123.5
Sep	61,067.3	68,179.2	-7,111.9
Oct	65,652.6	75,445.3	-9,792.7
Nov	53,877.9	65,944.3	-12,066.4
TOTAL (1)	609,463.0	693,641.2	-84,178.2
JAN - NOV 2007			
TOTAL (1)	449,357.9	517,410.7	-68,052.7

(1) Total After Adjustments (year-to-date)

Comment: The trade balance improved during the first half of the year as a result of growing merchandise exports, but deteriorated during the second half due to rising imports. Merchandise export growth stagnated in the third quarter due the slowdown in global demand and the substantial decline in international commodity prices. Sluggish growth in export volumes was recorded in the subcategory for motor vehicles and transport equipment, while the volume of exported machinery, electrical equipment and precious metals receded in the third quarter. Merchandise imports increased in the third quarter despite the moderation in domestic economic activity and more stringent international credit conditions. Economists expect the trade balance to narrow in 2009 as weak domestic spending contains import volumes and the global recession keeps import prices under control. Export volumes and prices will also be impacted by the global downturn, but exporters will receive some support from a weaker rand. End Comment.

¶8. FOREIGN RESERVES ($ billions)

	2008 Jul	Aug	Sep	Oct	Nov
SARB Gross Gold and Foreign Reserves	35.00	34.33	34.42	32.91	33.22
SARB Net Open Forward Position	34.17	33.50	33.64	32.11	32.58

Comment: South Africa's gross foreign reserves decreased slightly in the third quarter of 2008. Valuation changes rather than outflows

caused these declines. Uncertainty and volatility in global financial markets inhibited the SARB's natural tendency to accumulate reserves. Economists expect South Africa's reserve position to remain under pressure in 2009, given the weakness of the rand and volatility in financial markets. End Comment.

II. QUARTERLY FIGURES

¶9. REAL GROSS DOMESTIC PRODUCT (percent change, seasonally adjusted and annualized)

	2007 Q3	Q4	2008 Q1	Q2	Q3
Primary Sector	1.7	1.2	-14.5	19.2	-0.5
Agriculture	7.1	15.5	16.2	19.4	16.1
Mining	-0.4	-4.4	-25.8	19.2	-8.0
Secondary Sector	1.6	9.4	1.2	11.8	-2.6
Manufacturing	-1.4	9.0	-0.6	14.3	-6.9
Electricity	3.6	-0.8	-5.8	-2.1	3.0
Construction	15.5	17.8	13.9	9.1	15.0
Tertiary Sector	6.1	4.7	3.7	1.6	1.5
Trade & catering	4.4	2.0	4.1	-4.0	-6.9
Transport & Comm.	4.5	3.6	3.4	4.3	4.5
Finance	10.4	8.0	2.6	3.3	3.2
Government	3.7	4.3	4.6	2.5	3.9
TOTAL	4.5	5.4	1.6	5.1	0.2

Comment: South Africa's real GDP growth slowed noticeably in the third quarter of 2008, recording the lowest quarterly growth rate in ten years. The sluggish growth was visible in all the major goods-producing sectors of the economy.

Primary sector: The decline in economic activity in the primary sector in the third quarter was primarily the result of a decline in mining production, in particular, in platinum-group metals, gold, Qmining production, in particular, in platinum-group metals, gold, diamonds, and coal. Lower growth in the third quarter also reflected the statistical effect of the high base established in the second quarter, and was exacerbated by weaker international demand and falling commodity prices. Platinum output was adversely affected by intensive maintenance programs usually conducted in February, safety-related shutdowns and one-day strikes. In contrast, the agricultural sector made a positive contribution to overall growth in the third quarter, benefiting from increased planting of field crops and bolstered by favorable weather conditions.
The result was a bumper maize crop.

Secondary sector: Growth in the secondary sector turned negative in the third quarter, mainly due to a decline in manufacturing output. The decline in manufacturing was caused by slowing domestic demand, falling commodity prices, and decelerating global economic growth. Notably slower growth was observed in the subsectors for motor vehicles, parts and accessories, textiles, clothing, leather and footwear, and food and beverages. The domestic demand for these products was probably affected by the sluggish growth in real income, higher interest rates, and already high debt levels, which inhibited the take-up of more credit. However, the construction sector remained buoyant in the third quarter, benefiting from the upgrading of existing infrastructure and large projects such as the Gautrain, power stations, roads, sport stadiums and related infrastructure developments for the 2010 FIFA World Cup under construction.

Tertiary sector: The slower pace of growth in the tertiary sector reflected a slowdown in the trade sector. This sector slipped into a technical recession following negative growth in the second and

third quarters. Tighter credit conditions and inflationary pressures negatively affected consumer spending and consumer confidence levels in the third quarter of 2008. Growth in the financial services sector, the largest sector of the economy, moderated marginally in the third quarter. This was due to a moderation in the real output in the banking sector, which was partly offset by higher trading volumes in equities, bonds and other financial market instruments, as investors repositioned themselves in a volatile market. The increase value added in the general government sector was largely due to increased employment in the sector. End Comment.

¶10. BALANCE ON CURRENT ACCOUNT (R millions)

	2007 Q4	2008 Q1	Q2	Q3
Merchandise Exp.	133,320	138,082	172,201	178,975
Net Gold Exports	11,268	11,516	11,877	10,239
Merchandise Imp.	152,260	161,474	188,411	204,626
Income Payments	33,497	31,608	29,566	34,380
Service payment	30,418	30,579	36,642	36,241
Current Account	-37,431	-42,773	-40,485	-52,827
Current Account Deficit/GDP (percentage)	-7.2	-9.2	-7.3	-7.9

Comment: The widening deficit on the current account in the third quarter reflected the impact of the slowdown in global economic activity and a substantial decline in international commodity prices as well as an increase in merchandise imports. The decline in global demand affected both the volume and prices of merchandise exports adversely. Over the same period, the growth in the value of merchandise imports also slowed alongside the moderation in domestic economic activity and more stringent international credit conditions. The trade deficit was further exacerbated by higher income payments accruing to non-resident investors on their investment in domestic securities. End Comment.

¶11. BALANCE ON FINANCIAL ACCOUNT (R millions)

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	2007 Q4	2008 Q1	Q2	Q3
Direct Investment	7,401	35,432	1,310	16,920
Portfolio Investment	-6,055	-20,572	22,466	-12,970
Other Investment	35,280	40,525	14,798	20,550
Financial Account	36,507	55,385	38,574	24,500

Comment: South Africa continued to attract capital inflows to finance the current account deficit in the third quarter of 2008. As in the first quarter of 2008, when portfolio investments turned negative, capital inflows in the third quarter were from direct and other investment capital. The outflow of portfolio capital reflected conditions in the global capital markets where foreign

investors limited their exposure to emerging-market assets and transferred funds to familiar home markets. Other investment flows consisted mainly of short-term foreign loans drawn upon by South African banks, as well as non-resident investors' foreign-currency denominated deposits with these banks. End Comment.

¶12. KEY LABOR MARKET VARIABLES (thousand)

	2007 Sep	2008 Q1	Q2	Q3
Employed	13,234	13,623	13,729	13,655
Unemployed	3,945	4,191	4,114	4,122
Total Labor Force	17,178	17,814	17,844	17,777
Not Econ. Active	13,235	12,794	12,861	13,024
Population 15-64	30,413	30,608	30,705	30,801
Unemployment rate (percentage)	23.0	23.5	23.1	23.2
Absorption rate (Employed/population ratio)	43.5	44.5	44.7	44.3

Comment: Unemployment in South Africa increased from 23.1 percent in the second quarter of 2008 to 23.2 percent in the third quarter. The number of employed persons decreased by 74,000 to 13.6 million. The decrease in employment was primarily due to a drop in informal sector employment, which more than offset a gain of 24,000 new jobs in the formal sector and the creation of 89,000 new jobs by private households. The prospect of slower economic growth in 2009 will slow employment growth and result in job losses in some sectors of the economy. End Comment.

III. ANNUAL FIGURES

¶13. GROSS DOMESTIC PRODUCT
(R millions, at market prices)

	2005	2006	2007
Nominal GDP	1,543,976	1,745,217	1,999,086
GDP Growth Rate (constant 2000 prices, y-o-y growth percentage)	5.0	5.3	5.1

Comment: Strong growth in 2007 was due to high commodity prices, strong domestic consumer demand, and increased fixed capital investment. Economists expect economic growth to have slowed to between 3 percent and 4 percent in 2008. This slowdown is due to the sustained monetary policy tightening since mid-2006, energy supply constraints, and slower global growth. End Comment.

¶14. FINANCING OF GROSS CAPITAL FORMATION (R millions)

	2005	2006	2007
Savings by Households	1,296	-5,088	-6,827
Corporate Savings	40,265	29,322	14,914
Government Savings	-12,217	5,953	27,810
Consumption of fixed capital	190,705	219,506	256,373
Gross savings	220,049	249,693	292,270
Foreign Investment	62,179	110,198	146,076
Gross Capital Formation	282,228	359,891	438,346
Gross Savings/GDP (percentage)	14.3	14.3	14.6
Dependence on Foreign	22.0	30.6	33.3
QDependence on Foreign Investment	22.0	30.6	33.3

Foreign Investment/GDP (percentage)	4.0	6.3	7.3
Gross Capital Formation/GDP (percentage)	17.1	18.8	21.1

Comment: The savings rates for households and corporations continued to decline, while the government increased its savings rate in 2007. The government's higher savings rate was mainly due to an increase in tax revenue which more than offset growth in expenditure. Notwithstanding the minor improvement in the national savings/GDP ratio, South Africa's dependence on foreign capital to finance gross capital formation increased to its highest rate ever in 2007. Investment programs by private business enterprises, public corporations, and the general government boosted growth in gross capital formation. The ratio of gross capital formation to GDP increased to its highest level since 1985 and is approaching the SAG's target of 25 percent. Government savings are expected to decrease, if not end, in 2009, adding to even greater dependence on foreign capital to finance gross capital formation. End Comment

¶15. NATIONAL BUDGET (R billions)

Fiscal Year Ending 31 March:

	2005	2006	2007	2008
Total Revenue	347.4	411.2	482.7	559.8
Total Expenditure	368.6	416.8	470.2	541.7
Budget Balance	-21.2	-5.6	12.5	18.1
Budget Balance/GDP	-1.5	-0.4	0.7	0.9

Comment: The fiscal surplus in 2008, only the second since 1960, was the result of a large increase in tax revenue (owing to strong economic activity and stepped up revenue enforcement) that was only partly absorbed by additional expenditure. The fiscal surplus is expected to decline, if not disappear in 2009. End Comment.

¶16. GOVERNMENT DEBT (R billions)

Fiscal Year Ending 31 March:

	2005	2006	2007	2008
Total Debt	501.7	528.5	551.9	571.7
of Which:				
-- Domestic	431.8	461.2	469.0	475.2
-- Foreign	69.4	66.8	82.6	96.2
-- Other debt	0.5	0.4	0.3	0.2
Debt Service Cost	48.9	50.9	52.2	52.8
Government Debt/GDP (percentage)	36.8	33.2	28.9	25.4
Debt Service Cost/GDP (percentage)	3.4	3.2	2.9	2.6

Comment: The decline in government debt as a percentage of GDP can be attributed to the rapid growth of the economy and the creation of a fiscal surplus. Debt service costs have shown a steadily declining trend since peaking at 5.6 percent of GDP in the 1999 fiscal year. The decline in debt service costs has created the necessary "fiscal space" to finance social priorities. As a result, government spending on social priorities has more than doubled since ¶2003. End Comment.

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For additional information please consult the following websites:

South African Reserve Bank
South African Revenue Service
Statistics South Africa
QStatistics South Africa
National Treasury

BOST